



## **Ethics Workshop**

**Dublin**

**23 February 2012**

**Feedback Paper**

## **Part 1            Introduction**

On the 23 February CARB and IESBA invited interested parties to a joint workshop on specific ethical issues. CARB and IESBA wished to get feedback from Chartered Accountants and others who are CEOs, CFOs, members of Boards or Audit Committees or are responsible for risk management in companies, and Ethics and Risk Partners in firms auditing those companies.

The objective of the workshop was to debate current ethical issues impacting on companies, their Boards and Audit Committees and to provide input to CARB and IESBA on the future development of Ethical Standards and other regulations affecting Chartered Accountants.

CARB and IESBA would like to thank all those who participated for their constructive comments which will assist both parties in developing future policy and strategy in relation to the issues discussed.

Attendees were presented with a [Summary Paper](#) highlighting the specific ethical issues to be considered.

The issues discussed and feedback from attendees is included in Part 2.

## **Contacts**

Both CARB ([www.carb.ie/ethics](http://www.carb.ie/ethics)) and IESBA ([www.ifac.org/Ethics](http://www.ifac.org/Ethics)) have extensive information on their websites. In particular the CARB website includes a wide range of case studies for members facing ethical dilemmas. CARB welcomes any feedback on how the website could be improved; please send comments to [carb@carb.ie](mailto:carb@carb.ie).

## Part 2            Feedback on Discussions

### Conflicts of Interest

#### Issues for Discussion

In December 2011, the IESBA issued an [Exposure Draft](#) setting out proposed changes to the Code of Ethics addressing Conflicts of Interest.

The Code of Ethics contains two sections dealing with conflicts of interest:

- Section 220 for professional accountants in public practice states that professional accountants should take reasonable steps to identify circumstances which may create a conflict of interest and pose a threat to compliance with the fundamental principles, and, applying the conceptual framework, evaluate the significance of the threats and apply safeguards or, where no safeguards are appropriate, resign from the engagement.
- Section 310 for professional accountants in business recognises the professional accountant's responsibility to an employing organisation and the sometimes conflicting obligations to comply with the fundamental principles. This section also provides examples of safeguards which may be applied when conflicts arise.

In its Exposure Draft, the IESBA is not proposing any changes to the general approach of identifying, evaluating and managing conflicts of interest. The proposed changes will however provide more specific requirements and guidance for professional accountants in applying the conceptual framework.

The revised Code will include the following:

- A description of circumstances that might create a conflict of interest (Section 100, 220 and 310) and examples of such circumstances (see Appendix 1 and 2).
- In relation to professional accountants in public practice:
  - A requirement to take into account whether a 'reasonable and informed third party' would believe there was a conflict; and
  - A requirement to evaluate the potential threats within a network firm when there is 'reason to believe' that a conflict may exist.
  - A requirement to meet three conditions before a professional accountant can accept or continue an engagement when a conflict has been identified but consent cannot be obtained due to a possible breach of confidentiality (see Appendix 3).
- In relation to professional accountants in business:
  - A revised section 310 to better address conflicts of interest rather than conflicts of duty.
  - Advises that Section 310 should be read in conjunction with Section 300 which recognises that the professional accountant has a legitimate interest in the aims of his/her employing organisation.

- A requirement that a professional accountant in business be alert to interests and relationships that a 'reasonable and informed third party' would be likely to conclude might compromise compliance with the fundamental principles.

### **Feedback**

Ken Dakdduk, Chairman IESBA, presented the proposals of IESBA. Mr Dakdduk referred in particular to IESBA's proposals in relation to the following:

- (i) The reasonable and informed third party test – was the IESBA position overkill?
- (ii) Were the proposals in relation to network firms the correct approach?
- (iii) Were the examples sufficiently comprehensive?

The following comments were made by the attendees:

1. Attendees generally agreed that for network firms the clients did not understand the distinction between firms within the network; they generally considered these to be one firm, and that is how the firms tend to sell themselves in the market. That being the case the conflict check needs to be throughout the network.
2. With regard to the reasonable and informed third party, attendees questioned the existence and reasonableness of such a person. In general it was agreed that it had to be the professional accountants own instinct as to whether a conflict might exist. One attendee referred to the 'smell test'.
3. Most attendees expressed concern at the possible misuse of consent, whether informed or otherwise. Consent cannot be taken as dispensation. If there is a genuine conflict then the professional accountant should not act, consent does not change this. If however, the professional accountant concludes that they can still be objective then they should discuss this with the governance body before determining whether they should act.
4. Attendees responded positively to the examples provided by IESBA.

### **Illegal Acts**

#### **Issues for Discussion**

IESBA is currently [discussing](#) an exposure draft providing guidance to professional accountants in public practice and professional accountants in business on how to respond when encountering a suspected illegal act.

In the discussions IESBA are considering the following requirements:

- A professional accountant to sequentially approach disclosure within the client or employing organisation; escalating the matter to successively higher levels of management if the matter was not appropriately addressed;
- A professional accountant to disclose certain illegal acts to an appropriate authority if the professional accountant determined that the illegal act was of such consequence that disclosure would be in the public interest;
- The suspected illegal acts to be disclosed to an appropriate authority would have been:
  - Suspected illegal acts that directly or indirectly affect financial reporting; and

- Suspected illegal acts the subject matter of which falls within the expertise of the professional accountant.

IESBA will also consider imposing a requirement to disclose such matters to an appropriate authority or having a right to disclose.

### **Feedback**

Bob Franchini, Chairman Illegal Acts Task Force IESBA, presented the proposals of IESBA. In particular he summarised the respective public interest disclosure responsibilities of professional accountants in public practice and in business.

Mr Franchini reported that at IESBA there was no consensus for a requirement as it was felt that such a provision was overly onerous for professional accountants in public practice providing non assurance services and professional accountants in business.

IESBA has concluded that the most appropriate approach was to provide for a 'robust right' for auditors and a right for others. There is an expectation that the right would be exercised in appropriate circumstances.

The following comments were made by attendees:

1. A number of commentators noted that the public expected all professional accountants to act in the public interest and as such, in the public interest, should report illegal acts. This was of particular note in the current financial crisis where many of the perceived failings related to members in business.
2. Concerns were expressed as to what should be reported in particular what constituted the 'public interest'. It was noted that all journalists believe that if it's something they wish to know then that of itself makes it public interest. Attendees felt there needed to be some form of objective test.
3. Attendees commented that it is not always clear what constitutes an illegal act; what one Senior Counsel considered to be so may not be another Senior Counsel's view. In response, other attendees stated that a reasonableness test could be applied but the professional accountant should err on the side of making the report.
4. One attendee commented on the public outcry to light-touch regulation when it does not appear to work. He emphasised the need for CARB and the Institute to keep working to remain a credible regulator in face of the current criticism of the behaviour of members of the profession whether in business (i.e. executive and non-executive directors of banks and major companies) or auditors: the actions taken now must restore that credibility or self-regulation will go completely.
5. A number of attendees considered that the proposals from IESBA constituted a good position to move forward from. The general consensus from the meeting was that professional accountants should report. That if the approach was to provide a right (robust or otherwise) there should be an emphasis on the expectation that the right would be exercised.

6. Attendees acknowledged the difficulties of members in business and junior members in larger organisations.
7. Concern was also expressed at the lack of protection for ‘whistle blowers’ in Ireland.

In response to the above points IESBA commented as follows:

1. Noted the problem as regards legal protection and hoped that by developing this section of the code that it could be used to secure legislative protection.
2. Noted the attendees’ preference for a reporting obligation but sought to point out that in a global code, a move to an absolute requirement would be difficult.
3. Agreed that the identification of what constituted the public interest was an on-going problem which would need to be addressed by way of guidance.

## **Breaches**

### **Issues for Discussion**

In October 2011, the IESBA issued an [Exposure Draft](#) addressing breaches of a provision of the Code.

The Exposure Draft would, amongst other things, require a professional accountant to report as soon as possible all breaches of an independence provision to those charged with governance (the audit committee).

The IESBA is considering the comments it has received on exposure of the document. Some agree with the approach taken, others feel that trivial breaches (such as the holding of an immaterial financial interest ) should not be reported at all or should be reported on an established time line (for example on a six monthly basis).

### **Feedback**

Kate Spargo, Chairman Breaches Task Force, IEASBA, presented the proposals of IESBA. Ms Spargo referred attendees to the questions contained in the summary paper. In particular she highlighted that the proposed standard would

- (i) Require the reporting of all breaches to the audit committee (or governance body); and
- (ii) Require the audit committee to agree to the auditor continuing to act.

In light of this the issues, IESBA needed feedback on the following:

- (i) How would the audit committee feel about receiving notice of all breaches (however trivial)
- (ii) How common are breaches in the firms, and what was the extent of the possible reporting requirement?

The following comments were made by the attendees

1. One attendee asked IESBA if they had collected data to assess whether a problem actually existed as this should have been undertaken before introducing a standard to correct an unidentified problem.

2. There was a mixed response from attendees as to whether all matters should be reported. The following comments from members in business, are of note:
  - (i) An attendee expressed concern that having just read 125 pages setting out why the auditor was independent that he would not be informed about any (and all) breaches. He did accept that the timing of this notification could be different for more serious breaches.
  - (ii) One attendee expressed concern that the audit committee (or Board or other governance body) would become overwhelmed with information and could become 'technocrats'.
  - (iii) One attendee expressed concern at receiving trivial breaches, even if information on these were reported every six months.
  - (iv) A number of other attendees supported the audit committee being fully informed.
3. In general the professional accountants in public practice supported full disclosure of breaches to the audit committee to allow it to make an informed decision.
4. With regard to reporting, the attendees commented as follows:
  - (i) Trivial breaches could be reported at a prescribed time (say 6 monthly) with more serious breaches being reported immediately.
  - (ii) It would be appropriate for the Chairman or Deputy Chairman of the Board (or Audit Committee) to be notified of the urgent breaches rather than the whole Board or Audit Committee.
  - (iii) Notification should not be to executive directors.
5. With regard to reporting to a regulator, it was suggested that the auditor should keep a register and the regulator should have a right/duty to inspect the register.

## Barnier

### Issues for Discussion

In October 2010, the European Commission (EC) issued a green paper entitled 'Audit Policy: Lessons from the Crisis'. The paper noted that the EC would like to open a debate on the role of the auditor, the governance and independence of audit firms, the supervision of auditors, the configuration of the audit market, the creation of a single market for the provision of audit services, the simplification of rules for Small and Medium Sized Enterprises (SMEs) and Practitioners (SMPs) and the international co-operation for the supervision of global audit networks.

In December 2011 the EC issued proposals for a [Directive](#) amending the Directive on statutory annual accounts and consolidated accounts, and also proposals for a [Regulation](#) on specific requirements regarding the statutory audit of public-interest entities.

The major matters in the Regulation of relevance to the workshop related to new provisions relating to auditor independence, including rotation of auditors and non-audit services.

### **Feedback**

Richard George, Chairman Ethics Committee CARB, presented the key issues in the EC Proposal for Directive and Proposal for Regulation, insofar as they impacted on the Code of Ethics.

The following comments were made by attendees:

1. Members in business generally commented as follows:
  - (i) They did not see the need for changes to the current requirements in relation to rotation.
  - (ii) They could see an argument for audit firms not providing non audit services to audit clients. However there was an understanding that certain functions needed to be carried out by the audit by law.
  - (iii) They could see no argument for separation of audit firms.
  - (iv) Concern expressed that in the future we could be moving to government appointed auditors.
  - (v) Concern that the role of the Audit Committee to make decisions on non-audit services was being eroded.
2. Members in public practice generally commented as follows:
  - (i) That the proposals did not give any consideration to the impact on audit quality.
  - (ii) That the public interest entity definition was becoming unnecessarily wide.
  - (iii) That over the last 6-8 years there had been a steep decline in the provision of non-audit services provided to audit clients.
  - (iv) That we are now in an era of extensive public reporting and there were now detailed disclosure of non-audit services allowing the audit committee to make informed decisions.
3. One attendee commented in relation to 2(iii) above that the decline referred to was as result of decisions taken by companies themselves and not the profession which was unfortunate.